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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 41

GENERAL UTILITIES & OPERATING COMPANY
Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE
Respondent.

BRIEF FOR PETITIONER.

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On June 3, 1935, this Court granted petition for writ of certiorari to the United States Circuit Court of Appeals, Fourth Circuit.

It is not here intended to repeat the argument set forth in the brief supporting the petition for writ of certiorari, but to consider two recent Circuit Court decisions which have direct reference to the opinion of the Fourth Circuit in this appeal.

In this case, the Circuit Court of Appeals below (*Helvering* v. *General Utilities & Operating Company*, 74 Fed. (2) 972,) sustained the United States Board of Tax Appeals in its holding that a dividend had been declared by the General Utilities & Operating Company, payable in

common stock of the Islands Edison Company (29 B. T. A. 165).

In *Commissioner of Internal Revenue* v. *Columbia Pacific Shipping Company*, 77 Fed. (2) 759, decided May 20, 1935, the Circuit Court of Appeals for the Ninth Circuit also held that where a specific sum was set aside from the surplus earnings and appropriated for dividend distribution, that part of the distribution payable and paid in shares of stock owned by the corporation did not result in realized gain taxable as income to the corporation. The decision cited with approval the Board's opinion in this appeal (29 B. T. A. 934) which it says "was affirmed by the Circuit Court of Appeals for the Fourth Circuit January 8, 1935."

The honorable court below thus recognized a dividend distribution of property to the stockholders of the petitioner. *Eisner* v. *Macomber*, 252 U. S. 189. This was in conformity with the action of the Commissioner who, similarly in recognition of the vested right, title and ownership of the stockholders, had assessed and collected taxes from the stockholders on basis of the designated fair market value of the stock so received by them. (Article 627 of Treasury Regulations 74.) The Commissioner cannot now contend and the court below should not have held, on *argument* in appellate brief of counsel for the Commissioner, that the subsequent sale of the stock of Islands Edison Company by its owners (the stockholders) was a sale by the petitioner. No such issue was before the Board. *Helvering* v. *Rankin*, decided by this Court April 29, 1935.

However, the court did hold that the sale of this property, the stock of the Islands Edison Company, by the thirty-three stockholders of the petitioner, was a transaction "deliberately planned and carried out for the sole purpose of escaping taxation" and that "the sale of the stock in question was in substance made by the respondent

company through the stockholders as agents or conduits through whom the transfer of title was effected." (R. 71.)

In *George H. Chisholm* v. *Commissioner*, decided July 8, 1935, by the U. S. Circuit Court of Appeals, Second Circuit, the court said, with respect to this part of the decision of the Fourth Circuit in this appeal:

> "The result, as we view it, should have depended upon whether when the shareholders got the shares in distribution which had been contracted for sale, they were under legal liability to complete the bargain. The opinion declares they were. If not, they were free to choose whether or not to perform the company's contract; the company had not sold. So far as the decision may be thought to go further than this, we cannot agree."

The facts of record stipulated in the trial of the case are that "no contract of sale was entered into" by the officers of the corporation (R. 13, par. 3); that Lucas, the President of the Company, did not hold power of attorney to sell the stock for the petitioner or its stockholders (R. 22, par. 4); that at no time did the petitioner agree with Whetstone, President of the Southern Cities Utilities Company, or with the Southern Cities Utilities Company, "verbally or in writing, to make a sale to him or to the Southern Cities Utilities Company of any of the said stock except 910 shares of Islands Edison Company" (R. 19, par. 7); that "*if a sale* of the 20,000 shares of the common stock of the Islands Edison Company then owned by the General Utilities and Operating Company *was consummated*, such a sale would be made *only after* the General Utilities and Operating Company had distributed the Islands Edison Company shares to its stockholders." (R. 13, par. 3); that "counsel would prepare a written agreement embodying the terms and conditions of the said sale, said agreement to be submitted for *approval of the stock-*

holders of the Islands Edison Company *after* the distribution of said stock by the General Utilities & Operating Company" (R. 11, par. 3); that "the petitioner received no cash or other property for the distribution of said 19,090 shares of the Islands Edison Company common stock." (R. 20, par. 11.) Thus the question of agency was clearly stipulated out of the record.

Notwithstanding these facts of record and the court's own statement that the negotiations prior to the making of the dividend took place "without the stockholders or any of them who were ostensibly making the sale being informed, advised or consulted," the court nevertheless held that "the sale of the stock in question was in substance made by the respondent company through the stockholders as agents or conduits through whom the transfer of title was effected" (R. 71).

The sale contract dated March 26, 1938, executed by each of the stockholders in his own legal right, is a part of the record. (Exhibit E of Stipulation—original photostat, not printed.) (R. 19, par. 7.)

The Commissioner of Internal Revenue, in his assessment letter from which this appeal was taken under the provision of Section 274 of the Revenue Act of 1926, said that if the dividend resolution of the petitioner had "merely provided for the distribution of the stock as a dividend there would clearly have been no gain to the corporation."

The sole question, therefore, before the trial Board was whether the petitioner had made a taxable gain through a dividend distribution payable in stock of the Islands Edison Company which it had appreciated on its books at what the petitioner considered to be its fair market value. (Petition for Review in Fourth Circuit, R. 41.)

Helvering v. *Columbia Pacific Shipping Co., supra.*
First Utah Savings Bank v. *Commissioner,* 17 B. T. A. 804, affirmed 53 Fed. (2) 421.

This is not a case where the evidence is ambiguous or where the transaction is unreal.

Gregory v. *Helvering*, — U. S. —, 79 L. Ed. 295.

The stockholders in their vested right had the free exercise of their discretion in the approval of the contract of sale drawn by counsel, because it was so stipulated. There is no fact in the evidence to suggest that the stockholders "were under legal liability to complete the bargain." As "they were free to choose whether or not to perform the company's contract, the company had not sold."

Chisholm v. *Commissioner*, *supra*.

Conclusion.

It is respectfully submitted that the decision of the United States Circuit Court of Appeals, Fourth Circuit, is erroneous and should be reversed and that the decision of the United States Board of Tax Appeals that

> "the intent of the directors of the petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction and on authority of First Utah Savings Bank, *supra*, we hold that the declaration and payment of the dividend resulted in no taxable income"

should be sustained.

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